



ORS Examination of South Carolina Electric & Gas Revenue

Pursuant to
Public Service Commission of South Carolina
Order Nos. 2017-770 and 2017-769

South Carolina
Office of Regulatory Staff

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January 19, 2018

Executive Summary and Conclusion

In response to the Public Service Commission of South Carolina Orders asking that the South Carolina Office of Regulatory Staff (“ORS”) directly address whether the suspension of revised rates would force South Carolina Electric & Gas Company (“SCE&G” or “the Company”) into bankruptcy, ORS sought and utilized advice from bankruptcy counsel to assist in preparing this filing. The suspension of SCE&G’s Base Load Review Act (“BLRA”) revised rates collections is unlikely to force SCE&G into bankruptcy. This conclusion is based on an analysis prepared by ORS bankruptcy counsel who has been representing ORS in the Westinghouse Electric Corporation, LLC, *et al.* Chapter 11 bankruptcy proceeding since May 2017.

Background

On September 26, 2017, ORS filed pursuant to S.C. Code Ann. § 58-27-920, a Request with the Commission (“Request”) asking the Commission to Order: (1) SCE&G to immediately suspend all BLRA revised rates collections, and (2) further action including credits to future bills or refunds if the General Assembly amends or revokes the BLRA or a court of competent jurisdiction declares the BLRA unconstitutional. This matter was docketed by the Commission in Docket No. 2017-305-E. ORS filed its Request after reviewing the Attorney General Opinion labeling portions of the BLRA “constitutionally suspect” and considering other matters including a previously undisclosed report by the Bechtel Power Corporation (“Bechtel”). As discussed during oral arguments on December 12, 2017, the Bechtel report and information from it and an earlier draft should have been disclosed in SCE&G’s BLRA-required quarterly reports and to the Commission and ORS. Had this information been disclosed, the previous recommendations made by ORS to the Commission in BLRA dockets likely would have been different.

On December 20, 2017, the Commission issued Order No. 2017-769 in Docket No. 2017-305-E and Order No. 2017-770 in Docket No. 2017-207-E (“the Orders”). ORS received the Orders on the same day, December 20, 2017. In the Orders, the

Commission requested ORS to examine SCE&G's revenue as it relates to the Request to suspend revised rates. The Commission Orders also ask ORS to directly address whether there is any merit to the Company's assertions that suspension of revised rates would cause a cascading financial effect that would force the company into bankruptcy. The Commission's Orders directed ORS to complete the examination no later than thirty (30) days from December 20, 2017, subject to a reasonable request for an extension. Thirty days after December 20, 2017 is today, Friday, January 19, 2018. Those thirty days consisted of seventeen (17) non-holiday business days.

The Orders also consolidated Docket No. 2017-305-E with Docket No. 2017-207-E. In Docket No. 2017-207-E, the Sierra Club and the Friends of the Earth requested that the Commission initiate a proceeding to, among other things, determine the prudence of acts and omissions by SCE&G and to provide reparations to ratepayers in connection with the nuclear construction.

On December 27, 2017, ORS served Audit Information Requests ("AIRs") on SCE&G. Those AIRs were also mailed to the Commission via letter dated December 27, 2017, and can be found within Docket No. 2017-305-E on the Commission's website. SCE&G responses were due Friday, January 5, 2018. Prior to the AIR response due date, SCE&G asked for a thirty (30) day extension to respond to the AIRs. ORS denied SCE&G's request for a thirty (30) day extension, and instead agreed to a seven (7) day extension to Friday, January 12, 2018. The responses total over 750 pages, and are attached to this report minus the approximately 600 pages in work papers in response to AIR 1-1. ORS Attachment 1. ORS reviewed the responses over the past seven (7) days to provide this examination. A full audit would take upwards of ninety (90) days. ORS did not seek an extension to provide its examination, because an extension would delay the opportunity for the Commission to make a determination on the suspension of revised rates collections.

Examination

A possible suspension of the electric rates that were put into place to fund the financing of nuclear construction has led SCANA to invoke the specter of bankruptcy citing potential cascading financial effects. Attached are three memoranda drafted by ORS bankruptcy counsel, Rick Mendoza, Esquire titled as follows:

1. January 18, 2018 Memorandum Providing Assessment of Likelihood of a Bankruptcy by SCANA and/or SCE&G in the Event that the 18% Charge for Costs of the Failed Nuclear Project is Terminated. ORS Attachment 2.
2. December 7, 2017 Memorandum on the Ability and Likelihood of a Bankruptcy Court Deciding (1) the Constitutionality of South Carolina Statutes, and (2) Rates SCE&G may Charge to its Rate Payers. ORS Attachment 3.
3. October 5, 2017 Memorandum Summarizing the Effects of a SCANA Bankruptcy on the Rate Payers. ORS Attachment 4.

Mr. Mendoza is a certified bankruptcy and debtor-creditor law specialist, has over 34 years of bankruptcy experience, and is a Fellow in the American College of Bankruptcy. Most notable is the first memorandum in which Mr. Mendoza provides his assessment that there is a 35% likelihood of bankruptcy if revised rates are terminated.

In looking at revenues collected by SCE&G, approximately \$445 million in annual SCE&G revenue is attributed to the now abandoned nuclear construction. The \$445 million is referred to as "revised rates" and is collected from ratepayers in accordance with the BLRA to recover only the financing costs related to nuclear construction. The \$445 million is an approximation and varies month-to-month based on the number of customers and customers' electricity usage. SCE&G's most recent financial data available to ORS is for the twelve month period ending September 30, 2017. Actual revised rates revenues received for the twelve months ending September 30, 2017 is \$433.8 million. See attached ORS Attachment 1: AIR 1-18.

Excluding revised rates, base rates revenues total \$1.394 billion for the twelve month period ending September 30, 2017. See ORS Attachment 1: AIR 1-18. Non-nuclear construction base rate revenues are intended to support the provision of retail electric service and general operations. For instance, non-nuclear construction operations and maintenance expenses totaled \$534.6 million. See ORS Attachment 1: AIR 1-19 for SCE&G expense detail related to the twelve month period ending September 30, 2017. SCE&G's last base rate increase occurred in 2012 and reflects a 2011 test year.

SCANA's \$2.45 per-share year's dividend payment, times the approximate shares outstanding amounts to \$574 million, grossed up for taxes, or \$460 million, under the new tax rates, and \$350 million, net of taxes. A suspension or reduction of dividends could cause negative results. However, it is expected that any negative effect would only be temporary, as ultimately long-term debt would become the major source of new funding and there likely would be increased pressure from financing sources for SCANA to issue shares or restore dividends as proof of the Company's value. For comparison purposes, the recent suspension of Pacific Gas & Electric Company's dividend payments was attributable to an anticipation of lawsuits by homeowners for compensation for losses due to wildfires possibly caused by contact between electric lines and vegetation. Viewed from this perspective, suspension of dividends may become a necessity, but its effect on cash-flow is not clear.

Certainly, the covenants of the indentures (the agreement between bond issuers and bond holders) could be invoked limiting the companies' access to capital markets and impairing the Companies' ability to borrow, as provisions of credit facilities were triggered. The covenants could be invoked as the result of successful stockholder lawsuits. An inability to borrow short-term debt would limit SCE&G's ability to pay its daily expenses in a timely manner and increase the cost of debt, especially if there were a downgrade by a bond-rating agency. This may lead to a restriction in cash-flow where one or both companies would be unable to meet its obligations and would make the option to apply for bankruptcy an avenue for relief from the payment obligations.

SCE&G cited an impairment of the assets represented by the unfinished nuclear units as a negative cascading event. Based on ORS's understanding, an impairment may occur when future cash flows are insufficient to cover the costs. The abandoned nuclear units' construction work in progress ("CWIP") retains earning potential under the BLRA abandonment provisions. Whether or not SCE&G will be allowed future cash flows on the CWIP is not before the Commission in this Docket. Future cash flows related to the CWIP are uncertain and unknown, but no decision has been made to deny them. Accordingly, whether an impairment will occur or its value is unknown. In addition, regardless of the Commission action here, an impairment may nevertheless be triggered by other events and circumstances. For instance, if the Commission does not suspend revised rates, Company management may still invoke an impairment write off due to legislative activities.

If revised rates are suspended, it would seem logical that an impairment would be recorded for the revised rates collections and not the full value of CWIP. A write-down would have an accompanying reduction in Common Equity. ORS Attachment 5 includes the SCE&G Quarterly Report for the twelve months ended September 30, 2017, and filed with the Commission on December 7, 2017, in Docket No. 2006-286-EG. Exhibit A of ORS Attachment 5 shows a return on equity of 8.39% with revised rates and the nuclear construction CWIP removed; however, as understood during the December 12, 2017 oral arguments, Exhibit A does not reflect the return on equity as a result of an impairment. ORS Attachment 1: AIR responses 1-4 and 1-5 detail financial scenarios resulting from the suspension of revised rates collections. On information and belief, SCE&G is including the full nuclear construction cost of approximately \$5 billion as an impairment in the responses to AIR 1-4. As addressed above, no decision has been issued that results in the Company being denied future cash flows for the nuclear construction CWIP; therefore, due to uncertainty on the amount of an impairment, the specific effect of an impairment on SCE&G's rate of return, return on equity, or the Companies' creditworthiness cannot be determined. A decision on an impairment is a management decision of SCANA and SCE&G.

The rate-making process involves a balancing of the investor and the consumer interests. Federal Power Comm. v. Hope Natural Gas Co. 320 U.S. 591, 603, 64 S.Ct. 281, 288 (1944). ORS respectfully submits the Commission should take action based on the facts before it and its analysis of the law as presented in Dockets No. 2017-305-E and No. 2017-207-E. A suspension of revised rates - a portion of the total revenues collected by SCE&G - is unlikely to force bankruptcy.